

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Deputy Area Counsel (Financial Services)  
(Large Business & International)  
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subject: Net Operating Loss - Interaction between § 172(b)(3) and § 172(b)(1)(C), (G), and (J)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

**ISSUE**

Whether a taxpayer who makes an election under § 172(b)(3) of the Internal Revenue Code ("Code") for a taxable year may carry back a specified liability loss, farming loss, or qualified disaster loss from the same taxable year pursuant to subparagraphs (C), (G), and (J), respectively, of § 172(b)(1).

**CONCLUSION**

A taxpayer who makes an election under § 172(b)(3) for a taxable year may not carry back any portion of the taxpayer's net operating loss ("NOL"), including any portion of the NOL that is attributable to a specified liability loss (other than an amount described in § 172(f)(1)(A)), farming loss, or qualified disaster loss.

**BACKGROUND**

A taxpayer may have an NOL that includes a portion attributable to a specified liability loss, farming loss, or qualified disaster loss. Such losses have extended carryback periods that are different from the general carryback period. The issue has arisen as to

whether an election to relinquish the carryback period under § 172(b)(3) also relinquishes the extended carryback periods for such losses.

This issue arose in a case with respect to a qualified disaster loss, wherein the taxpayer contended that its § 172(b)(3) election did not prohibit it from carrying its qualified disaster loss back 5 years pursuant to § 172(b)(1)(J). Even though this particular taxpayer's case was resolved, you requested that we clarify the issue.

## LAW

Section 172(a) allows a deduction equal to the aggregate of the NOL carryovers and carrybacks to the taxable year.

Section 172(b)(1)(A) provides that an NOL for any taxable year generally must be carried back to each of the 2 years preceding the taxable year of the NOL and carried forward to each of the 20 years following the taxable year of the NOL.

Section 172(b)(1)(C) states that in the case of a taxpayer that has a specified liability loss (as defined in § 172(f)) for a taxable year, the specified liability loss shall be an NOL carryback to each of the 10 taxable years preceding the taxable year of the loss.

Section 172(b)(1)(G) states that in the case of a taxpayer that has a farming loss (as defined in § 172(i)) for a taxable year, the farming loss shall be an NOL carryback to each of the 5 taxable years preceding the taxable year of the loss.

Section 172(b)(1)(J) states that in the case of a taxpayer that has a qualified disaster loss (as defined in § 172(j)) for a taxable year, the qualified disaster loss shall be an NOL carryback to each of the 5 taxable years preceding the taxable year of the loss.

Section 172(b)(2) provides, in general, that the entire amount of the NOL for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried.

Section 172(b)(3) provides that any taxpayer entitled to a carryback period under § 172(b)(1) may make an irrevocable election to relinquish the entire carryback period for an NOL for any taxable year.

Section 172(c) provides, in general, that the term "net operating loss" means the excess of the deductions allowed by Chapter 1 of the Code over the gross income, computed with certain modifications.

Section 172(f)(1) provides, in general, that the term "specified liability loss" means the sum of the following amounts to the extent taken into account in computing the NOL for the taxable year: (A) any amount allowable as a deduction under § 162 or § 165 which is attributable to product liability, or expenses incurred in the investigation or settlement

of, or opposition to, claims against the taxpayer on account of product liability, and (B) any amount allowable as a deduction under Chapter 1 of the Code (other than § 468(a)(1) or § 468A(a)) which is in satisfaction of certain liabilities under a Federal or State law.

Section 172(f)(5) provides that, for purposes of applying § 172(b)(2), a specified liability loss for any taxable year shall be treated as a separate NOL for such taxable year to be taken into account after the remaining portion of the NOL for such taxable year.

Section 172(i)(1) provides that, in general, the term “farming loss” means the lesser of (A) the amount which would be the NOL for the taxable year if only income and deductions attributable to farming businesses (as defined in § 263A(e)(4)) are taken into account, or (B) the amount of the NOL for such taxable year.

Section 172(i)(2) provides that, for purposes of applying § 172(b)(2), a farming loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

Section 172(j)(1) provides that, in general, the term “qualified disaster loss” means the lesser of (A) the sum of (i) the losses allowable under § 165 for the taxable year attributable to a federally declared disaster (as defined in § 165(h)(3)(C)(i)) occurring before January 1, 2010, and occurring in a disaster area (as defined in § 165(h)(3)(C)(ii)), and (ii) the deduction for the taxable year for qualified disaster expenses which is allowable under § 198A(a) or which would be so allowable if not otherwise treated as an expense, or (B) the NOL for such taxable year.

Section 172(j)(2) provides that, for purposes of applying § 172(b)(2), a qualified disaster loss for any taxable year shall be treated in a manner similar to the manner in which a specified loss is treated.

Section 172(b)(1)(I), prior to the Omnibus Budget Reconciliation Act of 1990 (“1990 OBRA”), P.L. 101-508, provided that a product liability loss shall be a NOL carryback to each of the 10 taxable years preceding the loss year.

Section 172(j), prior to the 1990 OBRA, defined “product liability loss.”

Section 1.172-13(b)(1) of the Income Tax Regulations (“Regulations”) provides that, in general, the term “product liability loss” means the lesser of (i) the NOL for the current taxable year, or (ii) the total of the amounts allowable as deductions under § 162 and § 165 directly attributable to product liability and expenses incurred in connection with the investigation or settlement of or opposition to claims against the taxpayer on account of alleged product liability.

Section 1.172-13(c)(4) states that, if a taxpayer sustains during the taxable year both an NOL not attributable to product liability and a product liability loss (as defined in

§ 172(j)(1) and § 1.172-13(b)(1)), an election pursuant to § 172(b)(3)(C) (relating to election to relinquish the entire carryback period) does not preclude the product liability loss from being carried back 10 years under § 172(b)(1)(I) and § 1.172-13(a)(1). Since § 1.172-13 was finalized, § 172(j)(1), § 172(b)(3)(C), and § 172(b)(1)(I) have been amended and redesignated.

## ANALYSIS

Section 172(c) defines the term “net operating loss” as the excess of the deductions allowed by Chapter 1 of the Code over the gross income with certain modifications. Based on this definition, the NOL calculation encompasses all deductions for the taxable year allowed by Chapter 1 of the Code (with certain modifications), including any allowed deductions attributable to a specified liability loss, farming loss, or qualified disaster loss. Consequently, there is only one NOL for the taxable year.

For a taxpayer to be able to make separate § 172(b)(3) elections with respect to a specified liability loss, farming loss, qualified disaster loss, or loss that qualifies for a general 2-year carryback period, each of these losses must qualify as a separate NOL. For example, assume that a taxpayer incurs a \$100,000 loss, \$50,000 of which qualifies for a 2-year carryback period under § 172(b)(1)(A) and \$50,000 of which qualifies for a 10-year carryback period as a specified liability loss under § 172(b)(1)(C). If both of the losses qualify as separate NOLs, then in this circumstance § 172(c) does not define an NOL but rather the sum of the taxpayer’s separate NOLs for the taxable year. However, because § 172(c) does define the term “net operating loss,” the two \$50,000 amounts referred to above constitute portions of the NOL for the taxable year rather than two separate NOLs.

Because no more than one NOL exists per year, when a taxpayer elects to relinquish the entire carryback period with respect to an NOL pursuant to § 172(b)(3), the election applies to the entire NOL for the taxable year. Section 172(b)(3) does not allow a taxpayer to make the election for a portion of the NOL for a taxable year. In addition, no provision in the Code or the Regulations suggests that there can be multiple NOLs in a taxable year for purposes of the election under § 172(b)(3). Consequently, a taxpayer making an election under § 172(b)(3) is prohibited from carrying back any portion of the NOL, including any portion of the NOL attributable to a specified liability loss, a farming loss, or a qualified disaster loss.

Section 172(f)(5) allows a portion of the NOL attributable to a specified liability loss to be “treated as a separate net operating loss,” but the special treatment is strictly limited to determining the order in which the NOL is absorbed under § 172(b)(2) in a carryback or carryover year. Specifically, under § 172(f)(5), a specified liability loss is “taken into account after the *remaining portion* of the net operating loss for such taxable year.” (emphasis added). Here again, the statutory language is consistent with a taxpayer having only one NOL for the taxable year, of which a specified liability loss is a portion, rather than a separate NOL. Pursuant to § 172(i)(2) and § 172(j)(2), a farming loss and

a qualified disaster loss are each treated in a manner similar to a specified liability loss for purposes of applying § 172(b)(2).

However, § 1.172-13(c)(4) provides that, in general, the former § 172(b)(3)(C) election (relating to an election to relinquish the entire carryback period) does not preclude a product liability loss from being carried back 10 years under former § 172(b)(1)(I) and § 1.172-13(a)(1). Section 1.172-13, which was proposed on March 25, 1983 and finalized on August 26, 1986, provides guidance with respect to the carryback of product liability losses. Section 11811(b) of the 1990 OBRA combined pre-1990 OBRA § 172(j) (relating to product liability losses) with pre-1990 OBRA § 172(k) (relating to deferred statutory or tort liability losses) into current § 172(f), which contains rules relating to specified liability losses. It is our position that this regulation is limited to specified liability losses described in § 172(f)(1)(A) (relating to product liability losses) and does not apply to specified liability losses described in § 172(f)(1)(B), farming losses, or qualified disaster losses.

Accordingly, we conclude that a taxpayer may not carry back a specified liability loss (other than an amount described in § 172(f)(1)(A)), farming loss, or qualified disaster loss for a taxable year for which the taxpayer elects to waive the NOL carryback period under § 172(b)(3).

#### CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS

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Please call Seoyeon Sharon Park at (202) 622-4960 if you have any further questions.